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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 001807

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SUBJECT: BP AND GOAJ CONFIRM DEAL REACHED ON SHAH DENIZ GAS

REF: (A) BAKU 1794 (B) BAKU 1789 (C) BAKU 1771

Classified By: CHARGE D'AFFAIRES JASON P. HYLAND, PER REASONS 1.4 (B, D
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11. (C) SUMMARY: According to BP Azerbaijan President Bill Schrader, during a December 9 meeting with SOCAR President Rovnaq Abdullayev, SOCAR officially informed BP as the Shah Deniz Operator that that the Energy Ministers of Turkey, Azerbaijan and Georgia had agreed to redistribute Turkey's 2007 Shah Deniz volumes. According to Abdullayev, Azerbaijan will take 1.3 billion cubic meters (bcm), Georgia will take 0.8 bcm, and Turkey will take 0.7 bcm. Minister of Energy Natiq Aliyev confirmed this information in a December 11 telephone call with Charge. Aliyev added that the sales and purchase agreement would be finalized in a December 14 expert-level meeting in Baku. Schrader said that as part of this new agreement, Georgia and Azerbaijan are eager to move forward with First Gas ceremonies December 21-23 in Baku; Azerbaijan reportedly seeks high-level representation from the USG, UK Government and BP. Schrader said SOCAR seemed 'elated' that Azerbaijan, Turkey and Georgia cooperation would result in "beating the beast back" and buying no gas from Gazprom. However, MinEnergy Aliyev worries that Turkey may back out of the deal and asked for USG help in shoring up Guler's support. BP also notes that the deal still leaves Azerbaijan with a a daily shortage of some 200-300 million standard cubic feet per day (scf/d) of gas in January. End summary.

12. (C) On December 9 the Ambassador spoke with BP Azerbaijan President Bill Schrader about his meeting earlier that day with SOCAR President Rovnaq Abdullayev. Schrader said that as operator for the Shah Deniz field, he had been called in to see Abdullayev to receive a message from the GOAJ via SOCAR, subsequent to the December 8 Energy Minister Tbilisi Trilateral summit.

Shah Deniz Agreement Reached - First Gas to Follow?

13. (C) Abdullayev told Schrader that at the December 8 trilateral meeting, the Energy Ministers of Turkey, Azerbaijan and Georgia had agreed to re-distribute Turkey's 2007 Shah Deniz volumes. According to Abdullayev, Azerbaijan will take 1.3 billion cubic meters (bcm), Georgia will take 0.8 bcm, and Turkey will take 0.7 bcm.

14. (C) Energy Minister Natiq Aliyev confirmed this

information in a December 11 telcon with Charge. Aliyev said the GOAJ will host an expert level meeting in Baku on December 14 in which the gas redistribution volumes between the three countries would be finalized as a sales and purchase agreement. Aliyev also said that Turkey would not take its volumes until July 1, 2007. Aliyev expressed uncertainty to Charge regarding Turkish Energy Minister Guler's commitment to the deal and urged USG support to ensure Turkey's participation, noting that the US Embassy in Ankara has very good relations with Guler.

15. (C) Separately, Schrader informed us December 11 that at the December 8 trilateral, Georgia proposed that Azerbaijan host First Gas ceremonies in Baku December 21-23. Schrader said that in a December 11 meeting, Presidential Energy Advisor Ali Asadov announced to BP that President Aliyev supports Georgia's proposal and seeks high-level representation from BP (Lord Browne), the British Government, and the U.S. Government. Schrader said the timing is bad for BP, and asked for USG support in trying to change the dates for the ceremony. If the GOAJ persists in holding the First gas celebration December 21-23, Schrader said that he most likely would be the highest level BP official in attendance. Schrader told Charge December 11 that he believed Georgian President Saakashvili was the biggest proponent of this event, even though BP had been counseling him not to take these steps that would attract Russian ire. (We are trying to reach Presidential Energy Advisor Ali Asadov to discuss the GOAJ proposal for a December 21-23 First Gas celebration.)

"Beating Back the Beast"

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16. (C) Schrader told the Ambassador that the most remarkable aspect of his meeting with SOCAR was the attitude of defiance towards Russia, and of elation that "all three worked together to beat the beast back." Schrader said that per SOCAR, Azerbaijan and Georgia's stated objective was to "buy no gas from GAZPROM." According to Schrader, Azerbaijan was upset that Russia signed a gas deal with Armenia for USD 110 per thousand cubic meter (mcm), with Rovnag saying the most Azerbaijan would pay Russia is USD 130/mcm. Abdullayev said Azerbaijan would "burn crude if we have to" to avoid buying from Russia.

17. (C) According to Schrader, Azerbaijan might well have to "burn crude," since "no matter which way you cut it and how much gas you try to squeeze out of what is available," there will be a daily shortage of some 200-300 million standard cubic feet per day (scf/d) of gas equivalent in January (approximately 300,000 barrels, or about 50,000 barrels a day, of crude - a lot.) February and March will be easier and by April "we'll be out of the woods," Schrader told the Ambassador (repeating comments made in Ref).

18. (C) Schrader said Azerbaijan understands it must "suffer for a month to teach GAZPROM a lesson," but it seems prepared and even eager to do so to avoid buying gas from Russia. He said SOCAR wants to keep this deal a secret - it does not want GAZPROM to learn of the decision. In this connection, Abdullayev expressed concern about the Turkish Minister, who Rovnag said "agreed reluctantly" to the arrangement in Tbilisi, and who left "not feeling great about the outcome," perhaps feeling "he gave something up" by agreeing to sell some Turkish gas to Georgia for \$120 per mcm. SOCAR did not reveal any details of discussion in Tbilisi concerning compensation for Turkey. According to Schrader, SOCAR is fearful Turkey may "flake on the deal" and not show up in Baku on December 12.

19. (C) Schrader acknowledged openly to the Ambassador that the whole problem this winter was created because "we are five to six months late with Shah Deniz." He said Abdullayev

delivered a "warning" to Schrader for the ACG partners to increase the delivery of associated gas from the ACG field to SOCAR to support this nascent deal. To this end, BP said SOCAR asked for an additional 1.5 bcm in associated gas from ACG, in addition to the 1.5 bcm of free ACG gas it already is slated to get in 2007. BP's reply to SOCAR was that it will "give Azerbaijan as much as we can physically get to you (likely to be up to 300m scf/d) while Shah Deniz production is ramping up (BP expects to be fully on schedule with three wells by April 2007) and to get through the crisis period of January through March." However, BP won't agree to a blanket additional 1.5 bcm/a for all of 2007, which it says it needs for reservoir maintenance. Schrader was confident this difference can be worked out because SOCAR and BP are both looking at the January-March period as one that must be managed on a daily, not a yearly, basis. In BP's view, it is question of how much gas can be made available on any one day through the crisis period.

¶10. (C) Schrader said that BP and SOCAR's working group on the shorter-term gas needs will work "all day on Monday" (December 12) on technical details. SOCAR tasked BP to make sure the ACG partners are on board. (As reported reftel, Schrader had told the Ambassador that he was likely to get flak from his ACG partners for this offer of extra free associated ACG gas to SOCAR, but that he saw no other viable option.) Schrader told the Ambassador that SOCAR itself would work the commercial aspects of the re-distribution of Shah Deniz volumes with STATOIL as the marketer. Turkey has a contract for 300bcm from Shah Deniz, and "we'll let them" split it up any way they want," Schrader said.

BP's Next Steps

¶11. (C) Schrader said he has a meeting with Aliyev's energy advisor Ali Asadov on December 11 to present BP's plan, and that he has requested and expects to meet President after meeting Asadov, at which point he will brief Aliyev on the BP proposal to help Azerbaijan and Georgia through the winter. BP will keep trying to get Shad Deniz wells up and running as

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quickly as possible, and will get maximum ACG associated gas to Azerbaijan until the first three Shah Deniz wells are up and running. BP will also work with SOCAR on technical ways to get more out of the fields SOCAR is working.

COMMENT

¶12. (C) Schrader told the Ambassador that he is not planning for a December 14 meeting, as things are developing positively. Given that this meeting will be at an experts-level, simply to simply to finalize already-agreed volumes, it does not appear necessary to have USG representation at this meeting.
HYLAND